

# **ECONOMIC OUTLOOK AND REVENUE ESTIMATES FOR MICHIGAN**

**FY 2006-07  
AND  
FY 2007-08**



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# FOREWORD

The House Fiscal Agency (HFA) is pleased to provide this report to members of the Michigan House of Representatives. The report presents preliminary final General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2005-06, revised revenue estimates for FY 2006-07, and initial revenue estimates for FY 2007-08. Estimates reported herein will be presented to the Consensus Revenue Estimating Conference on January 18, 2007, and will be used to facilitate the consensus estimating process.

This report includes HFA analyses of important factors that will affect state and national economies through the year 2008, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for General Fund/General Purpose (GF/GP) and the School Aid Fund (SAF).

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# EXECUTIVE SUMMARY

The national economy slowed to 3.2% in calendar year (CY) 2005 and is expected to be 3.3% in CY 2006. The delayed effects of interest rate increases, high oil prices, a weakening housing market and a lower level of light motor vehicle sales were the primary factors that reduced economic growth in the last three quarters of 2006. National payroll employment grew 1.5% in CY 2005 and is expected to increase 1.4% in CY 2006.

Michigan's wage and salary employment has generally trended downward since mid-2000. In the third quarter of CY 2006, Michigan's wage and salary employment declined by 17,300 workers; over the past year, Michigan lost an average of 1,850 jobs per month.

## **U. S. Forecast**

Real GDP growth is forecast to increase 2.2% in CY 2007, down from an estimated 3.3% in CY 2006. Real GDP is forecast to grow 2.5% in CY 2008.

Inflation, as measured by the Consumer Price Index (CPI), is forecast to decline from an estimated 3.3% in CY 2006 to 1.9% in CY 2007 and 2.4% in CY 2008.

Light vehicle sales totaled 16.9 million units in CY 2005, declined to an estimated 16.5 million units in CY 2006, and are forecast to drop to 16.3 million in CY 2007 before rising back to 16.5 million units in CY 2008. The import share of light vehicles is forecast to be 22.8% in CY 2007 and 22.3% in CY 2008.

The national unemployment rate is forecast to be 4.6% in CY 2006 and CY 2007, then increase to 4.7% in CY 2008.

Interest rates on three-month T-bills are forecast to average 4.7% in CY 2006, then increase slightly to 4.9% in CY 2007 and 4.8% in CY 2008.

## **Michigan Forecast**

Michigan personal income increased an estimated 3.4% in CY 2006; the rate of growth is expected to decelerate 2.8% in CY 2007 and 2.9% in CY 2008.

Michigan's unemployment rate is estimated to be 6.7% in CY 2006, and is forecast to be 7.4% in CY 2007 and 7.8% in CY 2008.

Inflation, as measured by the Detroit Consumer Price Index, for CY 2006 is estimated to be 3.0%; it is forecast to decelerate to 1.4% in CY 2007, then increase by 2.1% in CY 2008.

### ***State Revenue***

Preliminary final total baseline GF/GP and SAF revenue was \$19.3 billion in FY 2005-06, and is forecast to increase by 2.3% to \$19.7 billion in FY 2006-07 and by 1.7% to \$20.0 billion in FY 2007-08.

Baseline revenue does not include the impact of partial-year policy changes or certain policy changes that have only recently occurred. Baseline estimates are comparable across fiscal years and demonstrate the changes to state revenue that are driven by changes in the economy.

Preliminary final total net GF/GP and SAF revenue was \$19.3 billion in FY 2005-06; it is forecast to increase \$294.3 million or 1.5% in FY 2006-07. The FY 2007-08 total net GF/GP and SAF revenue is forecast to total \$18.7 billion—a decrease of \$949.8 million or 4.8%; \$1.188 billion of this decrease is due to the repeal of the single business tax (SBT). If the SBT is replaced with a revenue neutral tax, then the total net GF/GP and SAF revenue would increase by \$238.2 million or 1.2% in FY 2007-08. Net revenue captures the effects of all policy changes and represents resources available.

**Table 1** reports GF/GP and SAF revenue in terms of baseline and actual revenue. Preliminary final FY 2005-06 estimates and the House Fiscal Agency's recommended revisions to estimates for FY 2006-07 are reported in **Table 2** and **Table 3**.

### ***State Revenue Limit***

Final total state revenue is expected to be below the state revenue limit by \$4.9 billion in FY 2005-06; it is estimated to be under the limit by \$5.3 billion in FY 2006-07 and \$7.2 billion in FY 2007-08. Final calculation of the state revenue limit is performed by the Auditor General.

### ***Fund Balances***

Beginning GF/GP balance is estimated to be \$7.0 million for FY 2006-07.

Beginning School Aid Fund balance is estimated to be \$0.0 million for FY 2006-07.

Beginning Countercyclical Budget Stabilization Fund balance is estimated to be zero for FY 2006-07 and FY 2007-08.



**Table 1**  
**HFA REVENUE ESTIMATES**  
(Millions of Dollars)

	<u>Preliminary Final</u> <u>FY 2005-06</u>	<u>HFA Estimate</u> <u>FY 2006-07</u>	<u>HFA Estimate</u> <u>FY 2007-08</u>
Baseline GF/GP	\$8,172.5	\$8,400.8	\$8,516.4
Baseline SAF	<u>11,097.7</u>	<u>11,305.0</u>	<u>11,514.9</u>
<b>TOTAL BASELINE</b>	<b>\$19,270.2</b>	<b>\$19,705.8</b>	<b>\$20,031.3</b>
Actual GF/GP	\$8,266.7	\$8,348.5	\$7,187.9
Actual SAF	<u>11,081.9</u>	<u>11,294.4</u>	<u>11,505.2</u>
<b>TOTAL ACTUAL</b>	<b>\$19,348.6</b>	<b>\$19,642.9</b>	<b>\$18,693.1</b>

*NOTE: Numbers may not add due to rounding.*

**Table 2**  
**FY 2005-06 HFA FINAL REVISIONS**  
(Millions of Dollars)

	<u>Adjusted</u> <u>May 2006 Consensus</u>	<u>January 2007</u> <u>Preliminary Final</u>	<u>Final Revision</u>
Baseline GF/GP	\$8,262.9	\$8,172.5	(\$90.4)
Baseline SAF	<u>11,213.8</u>	<u>11,097.7</u>	<u>(116.1)</u>
<b>TOTAL BASELINE</b>	<b>\$19,476.7</b>	<b>\$19,270.2</b>	<b>(\$206.5)</b>
Actual GF/GP	\$8,357.1	\$8,266.7	(\$90.4)
Actual SAF	<u>11,198.0</u>	<u>11,081.9</u>	<u>(116.1)</u>
<b>TOTAL ACTUAL</b>	<b>\$19,555.1</b>	<b>\$19,348.6</b>	<b>(\$206.5)</b>

*NOTE: Numbers may not add due to rounding.*

**Table 3**  
**FY 2006-07 HFA RECOMMENDED REVISIONS**  
(Millions of Dollars)

	<u>Adjusted</u> <u>May 2006 Consensus</u>	<u>January 2007</u> <u>Recommendation</u>	<u>HFA Recommended</u> <u>Revision</u>
Baseline GF/GP	\$8,506.0	\$8,400.8	(\$105.2)
Baseline SAF	<u>11,563.0</u>	<u>11,305.0</u>	<u>(258.0)</u>
<b>TOTAL BASELINE</b>	<b>\$20,069.0</b>	<b>\$19,705.8</b>	<b>(\$363.2)</b>
Actual GF/GP	\$8,453.7	\$8,348.5	(\$105.2)
Actual SAF	<u>11,552.4</u>	<u>11,294.4</u>	<u>(258.0)</u>
<b>TOTAL ACTUAL</b>	<b>\$20,006.1</b>	<b>\$19,642.9</b>	<b>(\$363.2)</b>

*NOTE: Numbers may not add due to rounding.*





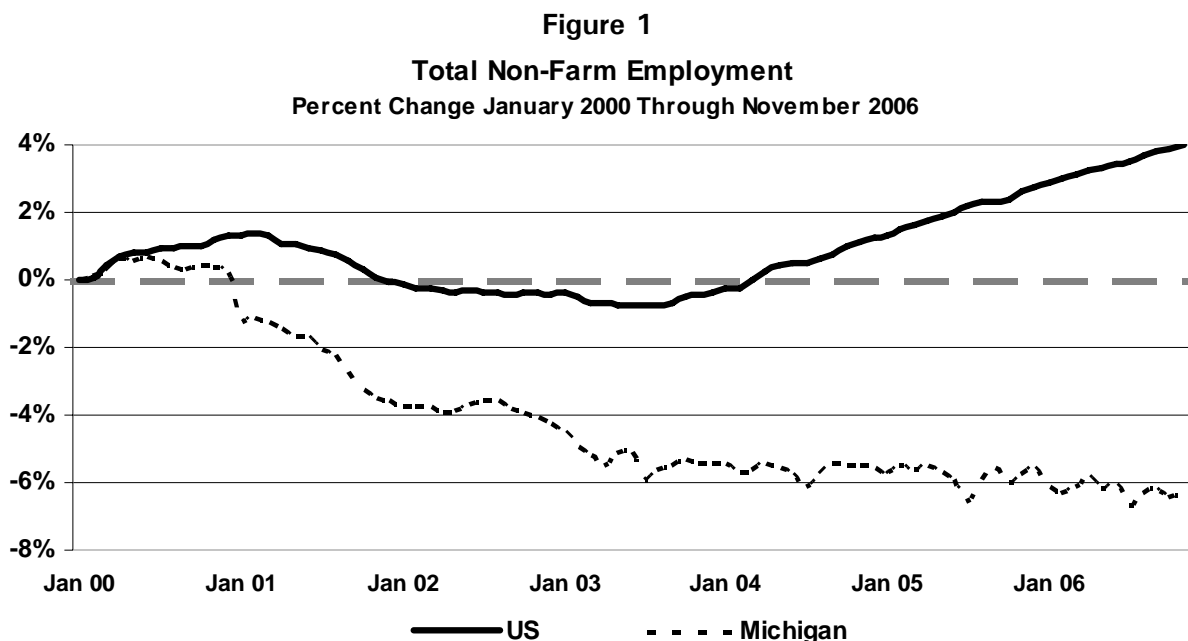
# ECONOMIC REVIEW AND FORECAST

This section presents the economic forecast used by the House Fiscal Agency to produce its revenue forecasts for FY 2006-07 and FY 2007-08.

The eight-month national recession that ended in November 2001 was followed by weak economic growth throughout CY 2002 and the early part of CY 2003. At the national level, economic growth accelerated at the end of CY 2003 and continued through CY 2005. Job growth at the national level began to improve during the latter half of CY 2003, and has continued its upward trend.

## Total Non-Farm Employment

**Figure 1** shows the monthly percent change in total non-farm employment for both the U.S. and Michigan from January 2000 through November 2006.



### ***U.S. Non-Farm Employment***

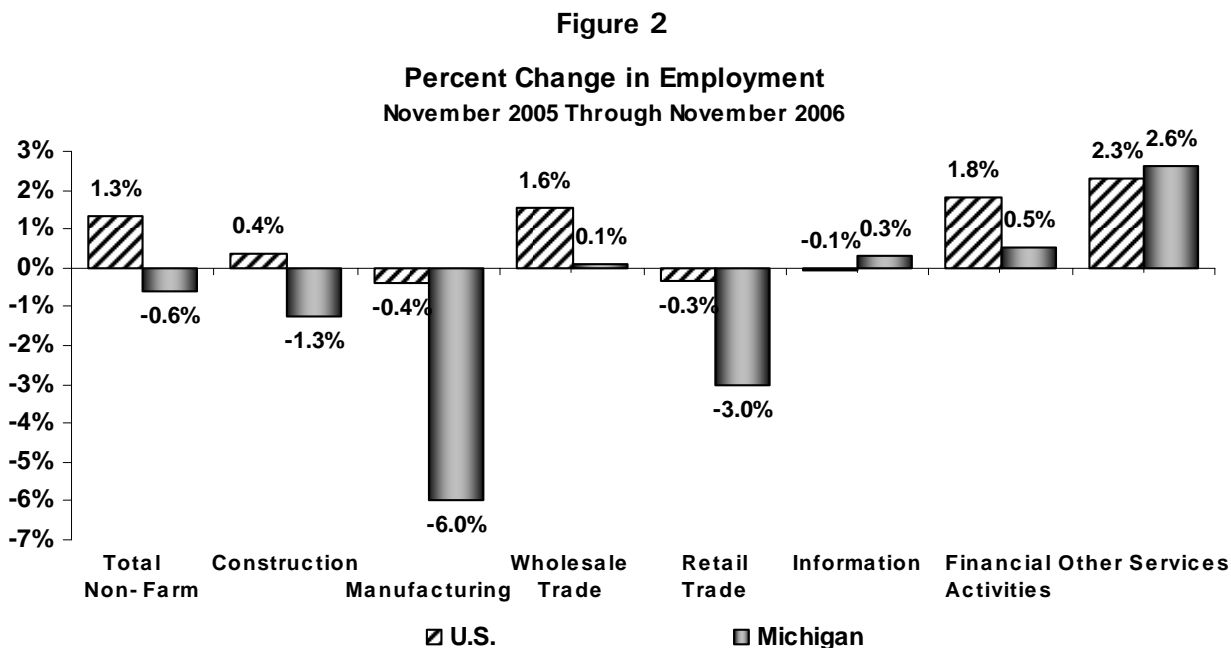
After U.S. employment peaked in February 2001, it began a long slide that did not end until May 2003. During this 29-month period, the national economy lost more than 2.7 million jobs, or about 100,700 jobs per month on average. In the 42 months since May 2003, more than six million jobs have been added.

### ***Michigan Non-Farm Employment***

Although employment has rebounded at the national level, conditions in Michigan are far less optimistic. Employment in Michigan peaked in June 2000, a full eight months before the national level peak in February 2001. Following the June 2000 peak, employment in Michigan dropped steadily until July 2003, resulting in a loss of more than 314,000 jobs—a 6.7% decline. Since then, employment in Michigan has fluctuated around the July 2003 level, with monthly job gains offset by subsequent monthly job losses. Between July 2003 and November 2006, more than 19,000 additional jobs have been lost.

### **U.S. and Michigan Employment**

**Figure 2** shows the percentage change in employment over the past year for all private workers and several important sectors of the economy for both the U.S. and Michigan. Although the U.S. gained almost 1.8 million jobs over this period, employment in Michigan fell by more than 27,000 jobs.



### ***U.S. Employment***

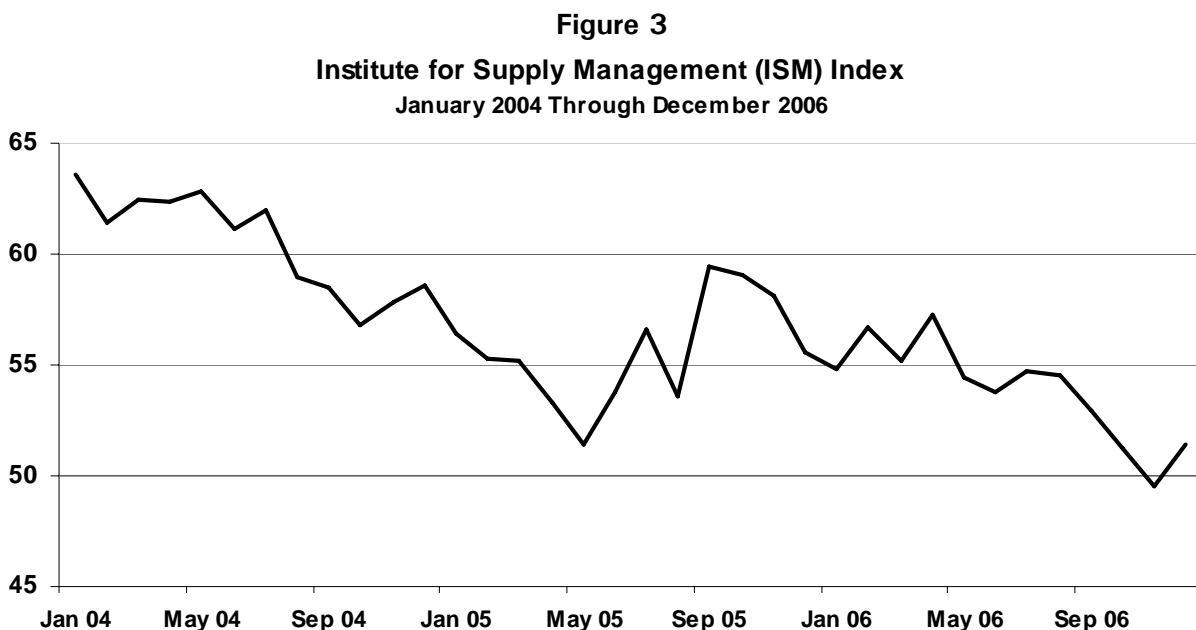
From November 2005 through November 2006, the U.S. experienced job gains in all sectors except manufacturing, retail trade, and information—which shed about 58,000, 50,000, and 2,000 jobs respectively. These job losses were more than offset by gains in all other sectors. The service sector, which grew by more than 150,000 workers, experienced employment growth of 2.3%, while the financial activities and wholesale trade sectors grew by more than 1.5%.

### ***Michigan Employment***

Job losses in Michigan over the past year were concentrated in the manufacturing and retail trade sectors, although the construction industry also experienced declining employment. Service sector growth of more than 2.6% over the past year was not enough to offset the loss of more than 40,000 manufacturing jobs. Michigan's manufacturing employment losses accounted for 70% of the total nationwide decline in manufacturing employment over the past 12 months.

### **Institute for Supply Management (ISM) Index**

**Figure 3** shows the ISM Index, a composite index of five economic indicators used to measure economic vitality beginning with January 2004. An index number above 50 indicates a growing manufacturing sector; a number below 50 suggests that the manufacturing sector is contracting.



The ISM index began January 2004 at a 20-year high of 63.3. This was followed by a 16-month slide that saw the index decline to 51.4 in May 2005. The index rose in three of the next four months, reaching a level of 59.4 in September 2005, before beginning a four-month decline to 54.8 in January 2006. With the exception of a brief increase in April, the index generally drifted downward in 2006. The index dipped below 50 in November (to 49.5), but ended the year with a slight upturn to 51.4.

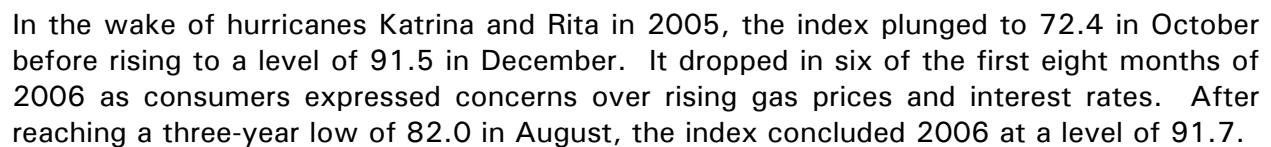
### **Index of Consumer Sentiment**

Consumer sentiment can be a strong motivator of personal consumption expenditures, which comprise almost two-thirds of GDP. **Figure 4** shows the University of Michigan Index of Consumer Sentiment beginning with January 2004.

Although the Index of Consumer Sentiment began January 2004 at a level over 100 for the first time in more than three years, it dropped in February and remained in the low-

**Figure 4**

**University of Michigan Index of Consumer Sentiment**  
January 2004 Through December 2006



**Figure 5** shows the estimated percent change in U.S. Real GDP for CY 2006 CY 2007 and CY 2008

### Percent Change in U.S. Real GDP



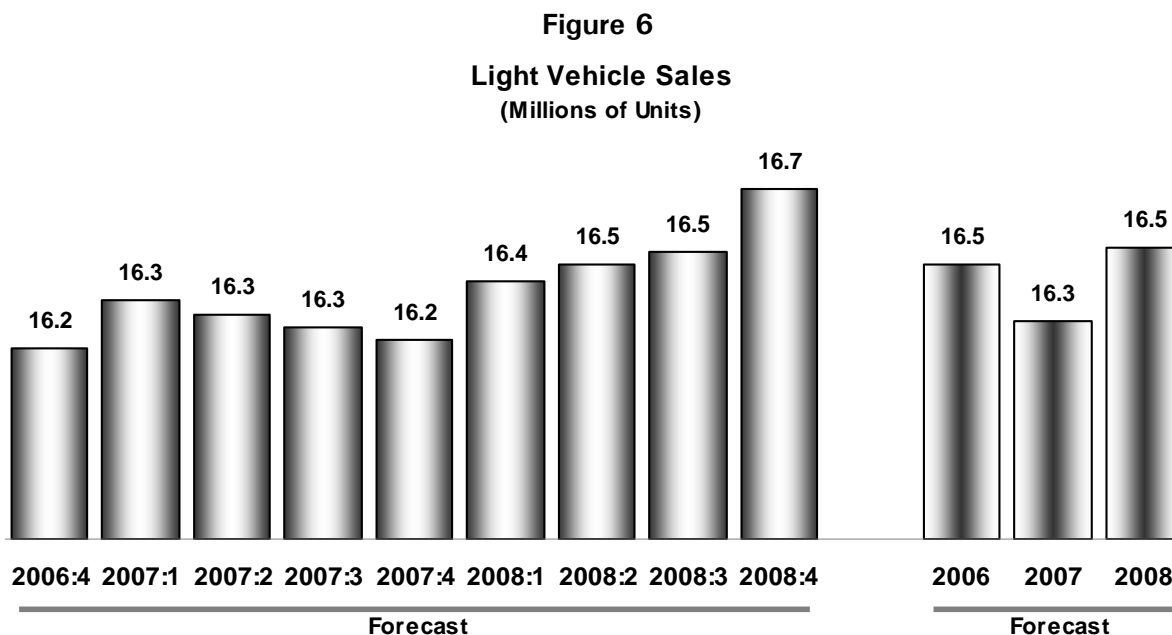
After rising 2.0% during the third quarter of 2006, real GDP is anticipated to grow by 2.3% in the fourth quarter. Real GDP growth, which was 3.5% in CY 2005, is forecast to be 3.3% in CY 2006, 2.2% in CY 2007, and 2.5% in CY 2008.

GDP growth continues to be fueled primarily by business investment. Gross private domestic investment is forecast to increase 5.8% in CY 2007 and 4.5% in CY 2008, which should more than offset projected declines in residential construction in CY 2007 and CY 2008.

Personal consumption advanced 3.5% during CY 2005. As the economy begins to slow down, growth in personal consumption is predicted to decline to 3.1% in CY 2006, 2.8% in CY 2007, and 3.0% in CY 2008.

### **Light Vehicle Sales**

**Figure 6** shows estimated light vehicle sales for CY 2006, CY 2007, and CY 2008.



Sales of light motor vehicles in CY 2006 are expected to total 16.5 million units—well below the CY 2000 record level of 17.2 million units. Light vehicle sales are anticipated to be 16.3 million units in CY 2007 and 16.5 million units in CY 2008.

Although there has been a shift in sales away from light trucks and toward cars over the past two years, the share of light trucks is expected to stabilize over the next three years. Light truck sales, which accounted for 54.8% in CY 2005, are expected to decline to 53.1% in CY 2006 before rising to 53.5% in both CY 2007 and CY 2008.

The import share of total light vehicle sales was 20.1% in CY 2005; it is forecast to increase slightly to 22.3% in CY 2006, 22.8% in CY 2007, and 22.3% in CY 2008.

## Inflation

### ***U.S. Inflation***

Input prices (e.g., wages and import prices) have remained moderate and have held down production costs. Crude oil and natural gas prices, which are expected to remain above historical norms, could impact almost all sectors of the economy.

Benchmark West Texas intermediate crude, which averaged over \$56 per barrel in CY 2005, began 2006 near \$64 per barrel and reached a high of \$74 per barrel in July before dropping back to \$62 per barrel by the end of the year. Because of continued concern over the stability of the oil supply and increased world demand, it is anticipated that oil prices will remain at this level throughout the forecast period and average about \$64 per barrel during both CY 2007 and CY 2008.

The annual rate of inflation, as measured by the percentage change in the U.S. Consumer Price Index-Urban (CPI-U), was 3.4% in CY 2005; it is expected to drop to 3.3% in CY 2006 and 1.9% in CY 2007 before increasing by 2.4% in CY 2008.

### ***Michigan Inflation***

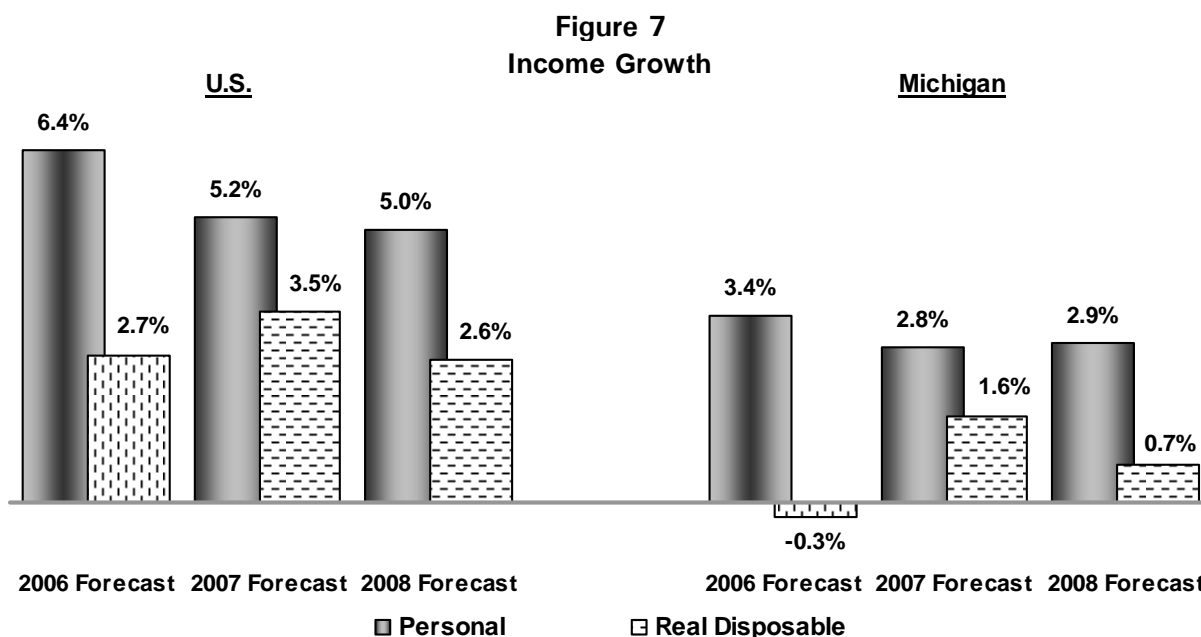
The cost of living in Michigan is measured by the Detroit Consumer Price Index for Urban Consumers (Detroit CPI-U). Michigan's average inflation rate was 2.9% in CY 2005. Inflation in Michigan should remain relatively low throughout the forecast period. The Detroit CPI-U is expected to increase by 3.0% in CY 2006, 1.4% in CY 2007, and 2.1% in CY 2008.

## Income Growth

Figure 7 shows personal and real disposable income growth for the U.S. and for Michigan.

### ***U.S. Income Growth***

Total U.S. personal income grew by 5.5% in CY 2005. Personal income growth is forecast to increase 6.4% in CY 2006, 5.2% in CY 2007, and 5.0% in CY 2008.





Slightly higher inflation contributed to a modest 1.5% growth of U.S. real disposable income in CY 2005. It is forecast that U.S. real disposable income will grow by 2.7% in CY 2006, 3.5% in CY 2007, and 2.6% in CY 2008.

### ***Michigan Income Growth***

Michigan's total state personal income growth was 3.4% in CY 2005. Michigan personal income is forecast to increase 3.4% in CY 2006, 2.8% in CY 2007, and 2.9% in CY 2008.

Michigan real disposable income declined 0.4% in CY 2005; it is forecast to fall by 0.3% in CY 2006 before increasing 1.6% in CY 2007 and 0.7% in CY 2008.

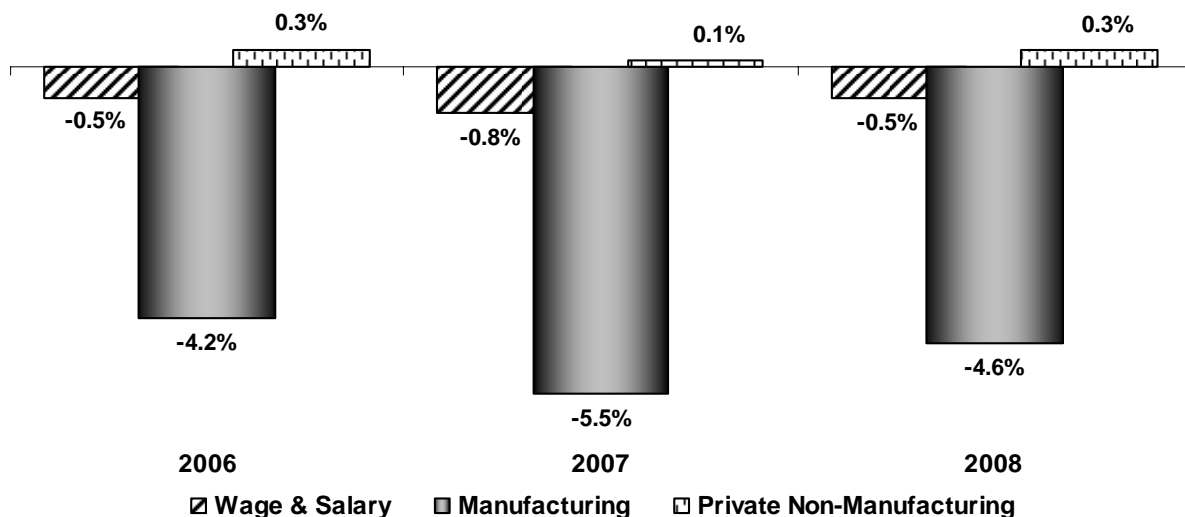
## **Employment**

**Figure 8** shows Michigan wage and salary, manufacturing, and private non-manufacturing employment growth.

### ***U.S. Employment***

One critical factor underscoring the difference in income growth between the U.S. and Michigan is overall job growth. Nationally, total non-farm employment posted average gains in excess of 149,000 per month during the first 11 months of 2006—a 1.2% overall growth rate. Total non-farm employment is projected to increase by 1.4% in CY 2006, before growing by just 1.0% in CY 2007 and 0.7% in CY 2008 as the economy begins to slow.

**Figure 8**  
**Michigan Employment Growth**



### ***Michigan Employment***

The Michigan economy has continued to endure a weak labor market; wage and salary employment declined by about 7,800 workers in CY 2005 and is estimated to decline by more than 22,000 workers in CY 2006, 33,000 workers in CY 2007, and almost 22,000 workers in CY 2008. The forecast calls for continued quarterly job losses through the third quarter of CY 2008.

Michigan wage and salary employment fell 0.2% in CY 2005, and is forecast to fall 0.5% in CY 2006, 0.8% in CY 2007, and 0.5% in CY 2008. Over the past 25 years, Michigan wage and salary employment has grown at an average annual rate of about 1.0%.

Michigan manufacturing employment dropped 2.6% in CY 2005, and is forecast to decrease 4.2% in CY 2006, 5.5% in CY 2007, and 4.6% in CY 2008. Although the most significant declines are concentrated in the motor vehicle industry, employment declines also appear throughout the entire manufacturing sector.

Michigan private non-manufacturing employment rose a modest 0.5% in CY 2005; it is expected to increase 0.3% in CY 2006, 0.1% in CY 2007, and 0.3% in CY 2008.

## **Unemployment**

### **U.S. Unemployment**

As of November 2006, total non-farm employment increased in each of the past 39 months, which has helped to hold down the unemployment rate. During this period, job growth has averaged more than 150,000 workers per month. Although much of this growth has been in service-providing sectors, the goods-producing sector has also experienced growth during the past year. Only the manufacturing sector continues to shed jobs.

The U.S. unemployment rate was 5.1% in CY 2005; it is forecast to drop to 4.6% in both CY 2006 and CY 2007 before rising slightly to 4.7% in CY 2008.

### **Michigan Unemployment**

Employment in Michigan remains a major concern as employment growth has fallen during each of the past five years. Michigan's wage and salary employment is forecast to continue declining throughout 2007 and 2008. As a result, the unemployment rate is expected to remain relatively high through 2008 as increases in the labor force (and unemployment) more than offset any employment gains.

Michigan's unemployment rate was 6.7% in CY 2005, and is expected to remain at 6.7% in CY 2006 before rising to 7.4% in CY 2007 and 7.8% in CY 2008.

**Table 4**  
**ECONOMIC FORECAST VARIABLES**

	<u>Calendar 2005 Actual</u>	<u>Calendar 2006 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2007 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2008 Estimated</u>	<u>% Change from Prior Year</u>
<b><u>United States</u></b>							
Real Gross Domestic Product (Billions of 2000 dollars)	\$11,048.6	\$11,414.3	3.3%	\$11,664.9	2.2%	\$11,956.7	2.5%
Implicit Price Deflator GDP (2000 = 100)	112.7	116.1	3.0%	118.8	2.4%	122.2	2.8%
Consumer Price Index (1982-84 = 100)	195.3	201.7	3.3%	205.5	1.9%	210.5	2.4%
Personal Consumption Deflator (2000 = 100)	111.5	114.6	2.8%	116.5	1.7%	118.9	2.1%
3-month Treasury Bills Interest Rate (Percent)	3.1%	4.7%		4.8%		4.8%	
Aaa Corporate Bonds Interest Rate (Percent)	5.2%	5.6%		5.8%		6.2%	
Unemployment Rate—Civilian (Percent)	5.1%	4.6%		4.6%		4.7%	
Light Vehicle Sales (Millions of units)	16.9	16.5	-2.8%	16.3	-1.2%	16.5	1.6%
Passenger Car Sales (Millions of units)	7.7	7.7	0.8%	7.6	-2.2%	7.7	1.7%
Light Truck Sales (Millions of units)	9.3	8.7	-5.8%	8.7	-0.3%	8.8	1.5%
Import Share of Light Vehicles (Percent)	20.1%	22.3%		22.8%		22.3%	
Personal Income (Billions of current dollars)	\$10,239.2	\$10,899.0	6.4%	\$11,465.4	5.2%	\$12,036.7	5.0%
Real Disposable Income (Billions of 2000 dollars)	\$8,105.0	\$8,322.3	2.7%	\$8,612.7	3.5%	\$8,837.1	2.6%
<b><u>Michigan</u></b>							
Wage and Salary Employment (Thousands)	4,386.6	4,364.4	-0.5%	4,331.2	-0.8%	4,309.5	-0.5%
Unemployment Rate (Percent)	6.7%	6.7%		7.4%		7.8%	
Personal Income (Millions of current dollars)	\$331,304	\$342,622	3.4%	\$352,275	2.8%	\$362,501	2.9%
Real Personal Income (Millions of 1982-84 dollars)	\$173,601	\$174,325	0.4%	\$176,846	1.4%	\$178,180	0.8%
Real Disposable Income (Millions of 1982-84 dollars)	\$153,969	\$153,540	-0.3%	\$155,967	1.6%	\$157,005	0.7%
Wage and Salary Income (Millions of current dollars)	\$183,653	\$187,459	2.1%	\$189,665	1.2%	\$192,768	1.6%
Detroit Consumer Price Index (1982-84 = 100)	190.8	196.5	3.0%	199.2	1.4%	203.4	2.1%
Detroit CPI (FY) (1982-84 = 100)	189.1	195.9	3.6%	198.2	1.2%	202.4	2.1%





# RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, risks and uncertainties are inherent in any forecast. The key risks in this forecast stem predominantly from uncertainties surrounding energy prices, consumer and household finances, the housing market, and Michigan's motor vehicle industry.

## **Energy Prices**

The average West Texas Intermediate crude oil price was \$60 per barrel in the fourth quarter of 2006—the same as the year-ago quarter, but an \$8.00 drop from the first three quarters of 2006. Oil prices are forecast to average \$64 per barrel throughout CY 2007 and CY 2008.

Energy prices affect the economy primarily through disposable income allocation—because more income is used for energy-related goods, less is used for all other items. Energy prices could fall below the estimated level and cause economic growth to be stronger than anticipated, or they may be higher than estimated—resulting in economic growth below the forecasted level.

## **Consumer and Household Finances**

A lack of flexibility—due to a negative savings rate, declining or weakened home values, and high debt levels—has strained consumer and household finances; future consumption will have to rely more on growth in employment and income.

The negative savings rate is due largely to mortgage equity withdrawals, which increased the level of consumption in recent years. The savings rate averaged 2.1% between CY 2000 and CY 2004; in CY 2005 it declined to –0.4% and it is expected to be –0.9% in CY 2006. The household debt service ratio—an estimate of debt payments (mortgage and consumer) and disposable personal income—rose to a new peak of 14.5% for the last two quarters of CY 2006.

National real disposable income growth is forecast to accelerate to an average of 3.1% over the next two years—up from 1.2% in CY 2005 and 2.7% in CY 2006. Consumption is forecast to grow 2.8% in CY 2007 and 3.0% in CY 2008.

## **Housing Market**

National housing activity has remained exceptionally strong over the last several years, with consumer spending aided by refinancing activity on homes that have appreciated in value. Despite increases in short-term interest rates, long-term interest rates have not risen correspondingly—and housing prices have posted significant gains.

After a 10% increase in CY 2004, new and existing home sales increased approximately 5% in CY 2005. For the first ten months of 2006, however, new home sales decreased 18% and existing home sales decreased 8% from a year ago.

The housing market is expected to slow in response to the lagged affects of higher interest rates. Housing starts are forecast to decline 15.9% in CY 2007 then increase 3.3% in CY 2008. Consumer spending is expected to slow as the housing market cools in home sales and in refinancing activity.

## **Michigan's Motor Vehicle Industry**

The level and composition of light motor vehicle sales is a key component of Michigan's economy. Light vehicle sales were 16.5 million units in CY 2006 and are forecast to be 16.3 million in CY 2007 before increasing to 16.5 million in CY 2008. The import share of light vehicles was 22.3% in CY 2006, and is forecast to be 22.8% in CY 2007 and 22.3% in CY 2008.

The market share of the big three auto manufacturers declined to an all-time low of 53.6% in CY 2006, down from 56.9% in CY 2005. Imports and vehicles with a foreign nameplate that are made in the U.S. (transplants) have steadily gained in market share over the past several years. The extent to which the domestic nameplates can hold on to market share will have a direct impact on Michigan's economy. This forecast assumes that the big three market share will decline by 3.1% in CY 2007 and by 1.6% in CY 2008.

After a decline of 7.7% in CY 2006, Michigan transportation employment is forecast to decline 12.2% in CY 2007 and 11.0% in CY 2008. If the Michigan-produced market share of motor vehicles is more than anticipated, Michigan's economy and revenue growth will be higher than estimated.



## GF/GP AND SAF REVENUE

Revenue estimates are based on economic performance of the components of national and state economies discussed in the previous section. This section explains January 2007 House Fiscal Agency revenue estimates for GF/GP (**Table 5**) and SAF (**Table 6**) revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

### **GF/GP Revenue by Source**

#### ***GF/GP Baseline Tax Revenue***

Baseline GF/GP tax revenue totaled \$7,955.5 million in FY 2005-06; it is estimated to increase by \$194.7 million or 2.4% to \$8,150.3 million in FY 2006-07, and by \$115.6 million or 1.4% to \$8,265.9 million in FY 2007-08.

#### ***Total GF/GP Baseline Revenue***

Total baseline GF/GP revenue includes baseline tax revenue and non-tax revenue such as federal aid, licenses and permits, and transfers from the liquor purchase revolving fund. Total GF/GP baseline revenue was \$8,172.5 million in FY 2005-06; it is estimated to increase by 2.8% to \$8,400.8 million in FY 2006-07, and by \$115.6 million or 1.4% to \$8,516.4 million in FY 2007-08.

#### ***Net GF/GP Revenue***

Net GF/GP revenue takes tax changes into account and is available for expenditure each year. Preliminary net GF/GP revenue was \$8,266.7 million in FY 2005-06; it is forecast to increase by \$81.7 million or 1.0% to \$8,348.5 million in FY 2006-07, and decrease by \$1,160.6 million or 13.9% to \$7,187.9 million in FY 2007-08. As previously noted, much of the \$1.188 billion decrease from FY 2006-07 to FY 2007-08 is due to the SBT repeal. Without the SBT repeal, net GF/GP revenue would increase \$27.4 million or 0.3%.

### **SAF Revenue by Source**

#### ***Total SAF Baseline Revenue***

Preliminary total SAF baseline revenue was \$11,097.7 million in FY 2005-06; it is forecast to increase \$207.4 million (1.9%) to \$11,305.0 million in FY 2006-07, and increase \$209.9 million (1.9%) to \$11,514.9 million in FY 2007-08.

**Net SAF Revenue**

Net SAF revenue takes tax changes into account. Net SAF revenue totaled \$11,081.9 million in FY 2005-06; it is forecast to increase by \$212.6 million or 1.9% to \$11,294.4 million in FY 2006-07, and by \$210.8 million or 1.9% to \$11,505.2 million in FY 2007-08.

**Table 5**  
**GF/GP REVENUE ESTIMATES**  
(Millions of Dollars)

	Preliminary Final		Fiscal Year 2007-08 over 2006-07		
	FY 2005-06	FY 2006-07	FY 2007-08	%Change	\$Change
Personal Income Taxes	\$4,183.7	\$4,270.6	\$4,322.6	1.2%	\$52.0
Sales and Use Taxes	1,016.8	1,058.1	1,089.9	3.0%	31.8
SBT and Insurance Taxes	2,189.1	2,264.5	2,301.0	1.6%	36.5
Other Taxes	<u>566.0</u>	<u>557.1</u>	<u>552.4</u>	-0.8%	<u>(4.7)</u>
<b>GF/GP Baseline Tax Revenue</b>	<b>\$7,955.5</b>	<b>\$8,150.3</b>	<b>\$8,265.9</b>	<b>1.4%</b>	<b>\$115.6</b>
Non-Tax Revenue	<u>217.0</u>	<u>250.5</u>	<u>250.5</u>	0.0%	<u>0.0</u>
<b>Total GF/GP Baseline Revenue</b>	<b>\$8,172.5</b>	<b>\$8,400.8</b>	<b>\$8,516.4</b>	<b>1.4%</b>	<b>\$115.6</b>
Adjustments to Baseline	<u>94.2</u>	<u>(52.3)</u>	<u>(1,328.5)</u>	-2,440.2%	<u>(1,276.2)</u>
<b>Actual GF/GP Revenue</b>	<b>\$8,266.7</b>	<b>\$8,348.5</b>	<b>\$7,187.9</b>	<b>-13.9%</b>	<b>(\$1,160.6)</b>

*NOTE: Numbers may not add due to rounding.*

**Table 6**  
**SCHOOL AID FUND REVENUE ESTIMATES**  
(Millions of Dollars)

	Preliminary Final		Fiscal Year 2007-08 over 2006-07		
	FY 2005-06	FY 2006-07	FY 2007-08	% Change	\$ Change
Sales and Use Tax	\$5,302.2	\$5,381.8	\$5,479.5	1.8%	97.7
Income Tax Earmark	2,038.9	2,080.5	2,114.5	1.6%	34.0
State Education Tax	2,007.1	2,101.6	2,191.6	4.3%	90.0
Lottery/Casino Wagering	792.1	808.9	814.6	0.7%	5.7
Tobacco Taxes	472.2	462.7	453.5	-2.0%	(9.3)
Real Estate Transfer Tax	297.7	280.0	270.0	-3.6%	(10.0)
Other Taxes	<u>187.4</u>	<u>189.5</u>	<u>191.3</u>	0.9%	<u>1.8</u>
<b>Baseline SAF Revenue</b>	<b>\$11,097.7</b>	<b>\$11,305.0</b>	<b>\$11,514.9</b>	<b>1.9%</b>	<b>\$209.9</b>
Adjustments to Baseline	<u>(15.8)</u>	<u>(10.6)</u>	<u>(9.7)</u>	-8.5%	<u>0.9</u>
<b>Actual SAF Revenue</b>	<b>\$11,081.9</b>	<b>\$11,294.4</b>	<b>\$11,505.2</b>	<b>1.9%</b>	<b>\$210.8</b>

*NOTE: Numbers may not add due to rounding.*



## **HFA Estimates of Year-End Balances**

**Table 7** reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF.

Fiscal Year 2006-07 estimates are based on year-to-date appropriations and HFA revenue estimates. Final FY 2004-05 and FY 2005-06 figures are included.

Budget Stabilization Fund estimates are based on current balance estimates provided by the Michigan Department of Treasury and HFA estimates of future deposits and interest earned.

**Table 7**  
**YEAR-END BALANCE ESTIMATES**  
(Millions of Dollars)

	<u>Final FY 2004-05</u>	<u>Preliminary Final FY 2005-06</u>	<u>Estimated FY 2006-07</u>
General Fund/General Purpose	\$220.5	\$7.0	\$0.0
School Aid Fund	\$98.0	\$0.0	\$0.0
Budget Stabilization Fund	\$2.0	\$2.1	\$2.2

*School Aid Fund revenues are restricted; any year-end balance is carried forward to the subsequent year.*

## **BSF Year-End Balance**

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout economic and budget cycles. **Table 8** details deposits, withdrawals, interest earnings, and the year-end balance from FY 1990-91 through FY 2007-08. **Figure 9** shows the BSF fund balance and the BSF fund balance as a percent of total GF/GP and SAF revenue.

The BSF ending fund balance for FY 2005-06 was estimated at \$2.1 million. The BSF trigger calculation—based on Michigan personal income less transfer payments adjusted for inflation and actual or net GF/GP revenue—indicates no withdrawal or pay-in for either FY 2006-07 or FY 2007-08. The estimated ending fund balance for FY 2006-07 is \$2.2 million; the estimated ending fund balance for FY 2007-08 is \$2.3 million.

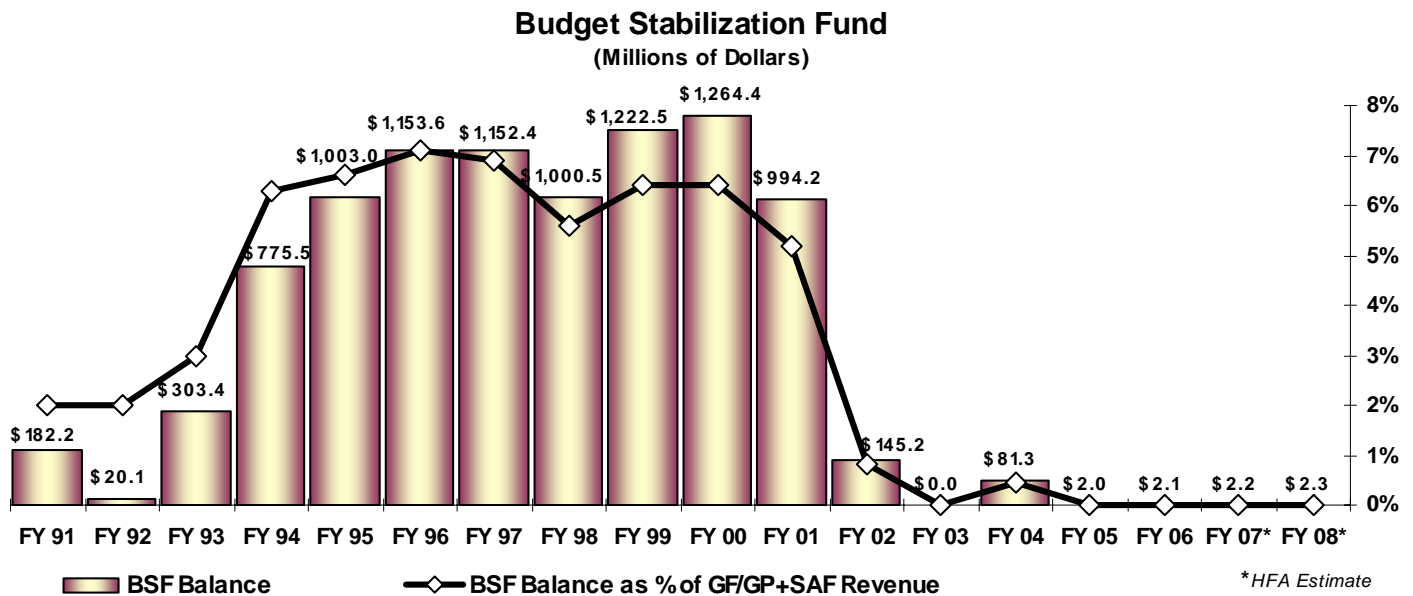
**Table 8**  
**BUDGET STABILIZATION FUND HISTORY**  
(Millions of Dollars)

<u>Fiscal Year</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest Earned</u>	<u>Balance</u>
1990-91	0.0	230.0	27.1	182.2
1991-92	0.0	170.1	8.1	20.1
1992-93	282.6	0.0	0.7	303.4
1993-94	460.2	0.0	11.9	775.5
1994-95	260.1	90.4	57.7	1,003.0
1995-96	91.3	0.0	59.2	1,153.6
1996-97	0.0	69.0	67.8	1,152.4
1997-98	0.0	212.0	60.1	1,000.5
1998-99	244.4	73.7	51.2	1,222.5
1999-2000	100.0	132.0	73.9	1,264.4
2000-01	0.0	337.0	66.7	994.2
2001-02	0.0	869.8	20.8	145.2
2002-03	0.0	156.1	10.9	0.0
2003-04	81.3	0.0	0.0	81.3
2004-05	0.0	81.3	2.0	2.0
2005-06*	0.0	0.0	0.1	2.1
2006-07*	0.0	0.0	0.1	2.2
2007-08*	0.0	0.0	0.1	2.3

\* HFA Estimates

NOTE: Numbers may not add due to rounding.

**Figure 9**



### **Compliance With the State Revenue Limit**

Article IX, Section 26 of the *Michigan Constitution*, which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income (which is the broadest measure of state economic activity) in the previous full calendar year prior to the fiscal year in which the revenues are measured.

The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation. Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

. . . For any fiscal year in the event that Total State Revenues exceed the limit established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund . . . .

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

As shown in **Table 9**, **Table 10**, and **Figure 10**, the final FY 2004-05 revenue limit calculation indicated that state revenue collections were \$4.22 billion below the revenue limit. For FY 2005-06, FY 2006-07, and FY 2007-08, state revenue is estimated to be substantially below the revenue limit—by \$4.88 billion, \$5.26 billion, and \$7.22 billion, respectively.

**Table 9**  
**COMPLIANCE WITH THE STATE REVENUE LIMIT**  
(Millions of Dollars)

<b><u>Revenue Limit Calculations</u></b>	<b><u>Final FY 2004-05</u></b>	<b><u>Estimated FY 2005-06</u></b>	<b><u>Estimated FY 2006-07</u></b>	<b><u>Estimated FY 2007-08</u></b>
Personal Income				
Calendar Year	<u>CY 2003</u>	<u>CY 2004</u>	<u>CY 2005</u>	<u>CY 2006</u>
Amount	\$314,460	\$324,134	\$331,304	\$342,622
X Limit Ratio	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>
<b>State Revenue Limit</b>	<b>\$29,842.3</b>	<b>\$30,760.3</b>	<b>\$31,440.7</b>	<b>\$32,514.8</b>
Total Revenue Subject to Revenue Limit	<u>25,626.8</u>	<u>25,880.4</u>	<u>26,178.3</u>	<u>25,299.7</u>
<b>Amount (Under) Over State Revenue Limit</b>	<b>(\$4,215.5)</b>	<b>(\$4,879.9)</b>	<b>(\$5,262.4)</b>	<b>(\$7,215.2)</b>

*NOTE: Numbers may not add due to rounding.*

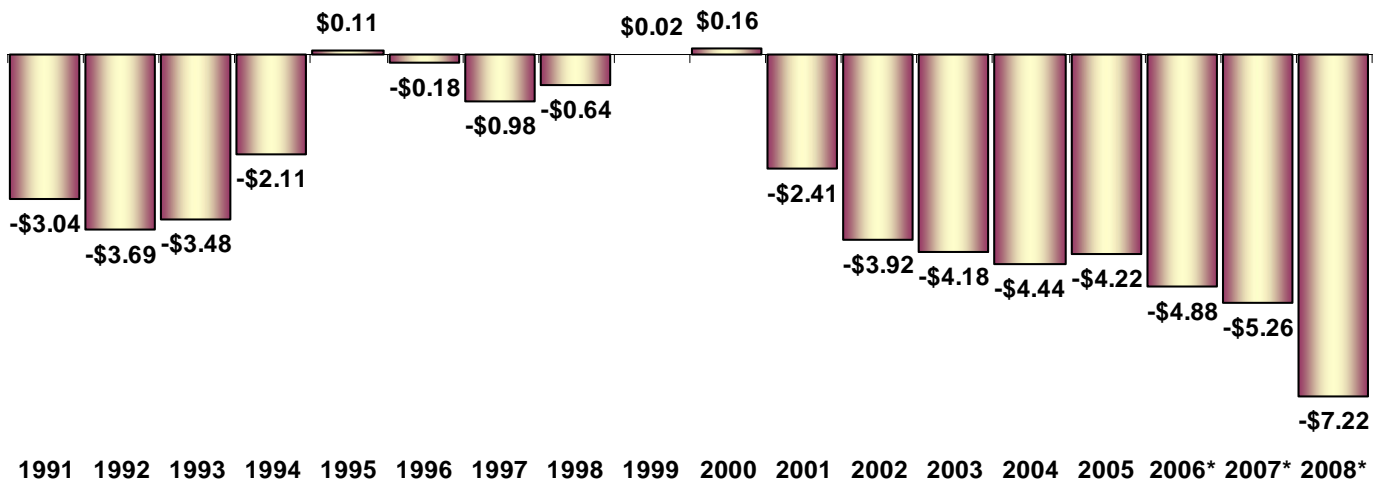
**Table 10**  
**CONSTITUTIONAL REVENUE LIMIT HISTORY**  
**(Billions of Dollars)**

<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>
1990-91	(\$3.04)
1991-92	(\$3.69)
1992-93	(\$3.48)
1993-94	(\$2.11)
1994-95	\$0.11
1995-96	(\$0.18)
1996-97	(\$0.98)
1997-98	(\$0.64)
1998-99	\$0.02
1999-2000	\$0.16
2000-01	(\$2.41)
2001-02	(\$3.92)
2002-03	(\$4.18)
2003-04	(\$4.44)
2004-05	(\$4.22)
* 2005-06	(\$4.88)
* 2006-07	(\$5.26)
* 2007-08	(\$7.22)

*\*HFA Estimate*

**Figure 10**

**Constitutional Revenue Limit**  
Amount Under or Over Limit (Billions of Dollars)



*\*HFA Estimate*





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